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Understanding the Influence of Financial Literacy and Risk Awareness on Investment Decisions and Economic Growth

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Abstract

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Investment is a crucial element in both the economy and individual financial planning, as it plays a significant role in driving economic growth, creating employment opportunities, and enhancing societal welfare. For individuals, investment serves as a tool to achieve long-term financial goals and protect assets from inflationary pressures. However, every investment carries inherent risks, including potential capital losses due to market fluctuations and uncertain economic conditions. Understanding these risks and maintaining a high level of financial literacy are key determinants of investment success, particularly for novice investors. The capital market, as a platform for trading long-term financial instruments, also plays a pivotal role in connecting surplus and deficit funds within society. This study aims to review the relationships among financial literacy, investment risk, and the capital market in promoting economic growth by synthesizing the latest empirical and conceptual literature. By analyzing contemporary findings, this review highlights the importance of informed decision-making, risk management, and financial education in optimizing investment outcomes and supporting sustainable economic development.

1. Introduction

Investment constitutes one of the main pillars in the economic development of a nation. Through investment, financial resources can be productively allocated to create economic value added and open new job opportunities. In a macroeconomic context, investment acts as the driving force of economic growth because it plays a role in increasing national production capacity and expanding infrastructure. According to Sun et al. (2023), both public and private capital investment contribute significantly to economic growth through increased productivity and innovation in the industrial sector.

Furthermore, investment also holds an important role in the lives of individuals. Through investment, a person can achieve long-term financial goals such as retirement funds, children's education, or property purchase. However, investment activity is inseparable from risks, such as market price fluctuations, interest rate changes, and global economic instability. Therefore, the ability to understand and manage risk is an important factor in determining investment success. This understanding cannot be separated from the level of financial literacy of the public, as low literacy often leads to errors in investment decision-making (Baihaqqy & Sari, 2020). The capital market is one of the main venues for investment activities, particularly for long-term financial instruments such as stocks and bonds.

This market functions as a meeting place between parties with surplus funds (investors) and parties needing funds (issuers), thereby creating efficiency in capital allocation. A healthy and transparent capital market is an important indicator of a country's economic stability. Besides providing an alternative source of financing for companies and the government, the capital market also encourages public participation in productive economic activities. However, the main challenge in increasing public participation in the capital market is the still low level of financial literacy. Many individuals still lack sufficient understanding of financial instruments, investment risks, and portfolio diversification strategies. In research conducted by Aisa (2021), it was found that financial literacy and the use of investment technology significantly influence a person's intention to invest in the capital market, especially during the COVID-19 pandemic. This finding indicates that education and technology can be a catalyst for increasing retail investor participation.

In addition, investment risk not only originates from external factors such as market volatility but also from internal factors such as investor behavior and emotional decision-making. In many cases, novice investors tend to act based on speculation or following market trends without deep analysis. Consequently, the potential for capital loss becomes greater. Therefore, it is important for investors to understand their risk profile before determining the type of investment to be taken. A study by Makkulau & Hajar (2024) confirms that financial literacy, investment promotion, and socioeconomic status influence stock investment decisions through risk perception.

This means that the higher a person's financial understanding, the better their ability to assess and manage investment risk. This suggests that financial literacy not only increases investor confidence but also fosters a healthy investment culture in society. In the context of Indonesia's economic development, increasing financial literacy is a strategic urgency. The government, educational institutions, and the financial sector need to collaborate in strengthening financial education from an early age so that the public has the awareness and ability to manage finances wisely. Thus, investment can serve as a means of individual economic empowerment while also driving sustainable national economic growth.

2. Literature Review

2.1. The Importance of Investment in Economic Growth

Investment holds a strategic role in strengthening the economic structure and improving community welfare. From a macro perspective, investment functions as a catalyst for economic growth because it can increase capital accumulation and national productivity. Sun et al. (2023) show that an increase in investment, both from the public and private sectors, significantly impacts economic growth in 34 Asian countries. This finding confirms that investment is not merely an instrument to increase national income but also plays a role in strengthening global competitiveness. The research by Suresh (2024) emphasizes the importance of individual investment decisions in driving the circulation of funds in the capital market. The more people who invest productively, the greater their contribution to capital formation and job creation.

In the Indonesian context, investment is an important source for strengthening national economic resilience, especially amid the dynamics of global economic turmoil. Furthermore, Khan et al. (2020) found that financial literacy and understanding of capital market investment have a significant positive relationship with economic development. People with good investment knowledge tend to be more active in utilizing formal financial instruments, thereby driving inclusive economic activity. Therefore, investment does not only function as a financial activity but also reflects the active participation of the community in sustainable and long-term oriented economic development.

2.2. Inherent Risk in Investment and Risk Management

Every form of investment has inherent risks that need to be carefully understood and managed. These risks arise due to market fluctuations, global economic uncertainty, and changes in monetary policy. Sun et al. (2023) emphasize that external uncertainty can suppress economic growth if not accompanied by effective risk mitigation policies. Therefore, investors are required to have the ability to diversify assets and accurately assess their risk profile. Aisa's (2021) research highlights the important role of financial literacy and technology in helping investors understand capital market risk. Individuals with high literacy levels tend to make investment decisions rationally, minimizing the influence of emotion, and are not easily swayed by market trends. In addition, technological developments, such as digital investment applications, facilitate portfolio monitoring and real-time risk evaluation, allowing for a quick response to changing market conditions.

Makkulau and Hajar (2024) assert that risk perception acts as a mediating variable in the relationship between financial literacy and investment decisions. In other words, the higher a person's level of literacy, the better their ability to assess risk and avoid potential capital losses. Therefore, increasing financial education is a crucial long-term strategy for improving the quality of public investment decisions. Effective risk management, supported by adequate financial literacy and the use of technology, is an important foundation for investors to achieve investment goals sustainably. This confirms that investment is not only a financial activity but also requires analytical skills and a mature understanding of risk to support stable economic development.

2.3. Financial Literacy and Participation in the Capital Market

Financial literacy is a fundamental aspect that determines the level of public participation in investment activities. Baihaqqy and Sari (2020) affirm that the level of education and financial understanding directly affects an individual's decision to invest in the capital market. Those who understand the basic principles of investment, such as risk, return, and diversification, tend to be more actively involved in formal financial markets. The findings of Khan et al. (2020) align with this, showing that increased financial literacy in the United States positively correlates with increased public participation in the stock market. This confirms that efforts to strengthen financial literacy have a tangible impact on financial inclusion and equitable economic welfare.

Furthermore, Gillani et al. (2023) emphasize the importance of synergy between public policy and financial education in building a healthy investment culture. Digital-based financial education programs are considered effective for reaching younger age groups and novice investors. This approach is in line with global trends, where millennials and Gen Z are increasingly active in retail investment through online platforms. Thus, financial literacy is a primary prerequisite for creating a sustainable investment ecosystem. Individuals with adequate financial knowledge will be better able to manage risk, choose investment instruments appropriate to their profile, and contribute positively to national economic development. A high quality of financial literacy not only supports rational investment decisions but also strengthens financial inclusion and long-term economic stability.

3. Method

This research applies the literature review method, a research approach that focuses on the analysis and synthesis of relevant previous research results related to the topics of investment, risk, financial literacy, and capital markets. This approach was chosen because it can provide a comprehensive understanding of the relationship between variables based on empirical evidence published within the last five years. The initial stage of the research began with the collection of scientific literature through the Google Scholar, Elsevier and Research Gate databases to obtain relevant academic articles. The criteria for literature selection included peer-reviewed journal articles published in the last five years, focusing on the topics of investment, risk, financial literacy, and capital markets, and published in national or international contexts with a clear empirical or conceptual approach.

From the search results, seven main articles were obtained and used as core references in this study. Some of these are the work of Baihaqqy and Sari (2020), which discusses the relationship between financial literacy and investment decisions in the capital market, Sun et al. (2023), which examines the role of investment and risk in economic growth, and Makkulau and Hajar (2024), which assesses the influence of financial literacy and risk perception on stock investment decisions. The next stage was content analysis, where each literature piece was examined in depth based on the research focus, the methodology used, the results obtained, and the suggested policy implications. This approach aims to find patterns, relationships, and connections between variables, for example, how financial literacy affects the level of investor participation or how risk plays a role in investment decision-making.

The analysis process was carried out thematically by grouping research findings into three main dimensions: the role of investment in the economy, risk management in investment activities, and the influence of financial literacy on investment decisions in the capital market. The results of each theme were then compared to identify similarities, differences, and to build a conceptual synthesis capable of explaining the relationship between variables more deeply. With this literature review approach, the research is expected to contribute theoretically to enriching investment studies and to provide an empirical basis for policymakers, financial institutions, and the public in improving the effectiveness of investment decision-making. This method allows for a broader and more holistic understanding of the dynamics of investment, risk, and financial literacy, while highlighting its practical implications for inclusive and sustainable capital market management.

4. Results

The results of the literature review indicate that investment plays a very important role, both in the context of the macroeconomy and in improving individual welfare. At the national level, investment is proven to be the main engine of economic growth because it serves to increase productivity and create jobs.

Meanwhile, at the individual level, investment is a strategic tool for achieving long-term financial goals, such as retirement funds, education, and personal wealth accumulation. The research by Ma et al. (2023) confirms that increased public and private investment contributes significantly to economic growth in Asian countries, particularly through the strengthening of industrial sectors and infrastructure. With effective management, investment not only increases global competitiveness but also strengthens national economic stability, thus becoming an important pillar in facing global economic dynamics.

At the individual level, investment also functions as a tool for protection against inflation and economic volatility (Silva et al., 2024). People who are able to manage investment wisely will be better prepared to face economic uncertainty and maintain personal financial stability. However, every investment activity is inseparable from inherent risks that can arise from various sources, including stock price fluctuations, changes in economic policy, and psychological factors that influence investor behavior. Therefore, risk management is a crucial aspect in maintaining the sustainability of an investment portfolio, so that investors can maximize potential returns while minimizing the possibility of loss.

The research by Raut (2020) emphasizes the importance of financial literacy in investment decision-making. Investors who have a better financial understanding tend to make rational decisions, are not easily influenced by market trends, and are better able to manage risk appropriately. In the Indonesian context, low financial literacy is a major challenge that limits public participation in the capital market. Many individuals do not yet understand investment risks and capital market mechanisms in depth, so they tend to avoid instruments that potentially offer higher returns, even though these instruments have greater profit opportunities.

The findings of Khan et al. (2020) support this by showing that financial literacy has a significant positive relationship with public participation in the financial market. Individuals with adequate financial understanding are more likely to invest in the capital market and other formal financial instruments. This indicates that financial literacy contributes not only to individual welfare but also to the national economy in aggregate. With increased public participation in the capital market, the circulation of funds in the economy becomes more optimal, which in turn encourages the growth of productive sectors and strengthens economic stability.

In addition to literacy, technology factors are also proven to be a key driver in increasing modern society's interest in investment. Disman et al. (2024) found that advances in financial technology, including online investment applications, play a significant role in increasing the public's intention to participate in the capital market. This technology not only simplifies access to information and transactions but also reduces psychological barriers for novice investors. The integration of financial literacy and technology enables a more efficient investment decision-making process and increases market participation more broadly, thus creating an investment ecosystem that is inclusive and affordable for various segments of society.

Although technology provides ease in investing, risk remains an undeniable part. Furinto et al. (2023) assert that risk perception acts as an important mediator between financial literacy and stock investment decisions. This means that individuals who understand risk deeply tend to make more cautious and measured investment decisions. This finding suggests that investment promotion carried out by the government or financial institutions must always be accompanied by an increased understanding of risk, so that investors are not only focused on potential profits but are also prepared to face the possibility of losses.

In the global context, Ma et al. (2023) emphasize the importance of synergy between investment, globalization, and risk management in economic growth. Countries with strong capital market structures and effective risk mitigation systems are proven to be more capable of maintaining sustainable economic growth, even when facing global crises. This condition indicates that healthy investment must be supported by good macroprudential policies and a stable financial system, thus minimizing the negative impact of international economic turmoil. Furthermore, the literature also shows that investment can be an instrument to increase economic equity. People who have access to the capital market and formal financial instruments are better able to develop assets and build family economic resilience. In the context of national development, equal access to investment is a strategic priority to encourage financial inclusion.

Efforts to increase financial literacy need to be accompanied by the provision of affordable, transparent, and easily accessible investment means, especially for middle-to-lower income communities, so that economic opportunities can be enjoyed more equitably. The research by Suresh (2024) also shows that the education factor has a significant influence on public understanding and participation in the capital market. The higher a person's level of education, the greater the likelihood that they will understand the benefits of investment and make appropriate financial decisions. This emphasizes that financial education must be an integral part of the national education system, to nurture a generation that not only has financial knowledge but is also able to apply that knowledge rationally and responsibly.

The findings of the literature review emphasize that investment, financial literacy, and risk management are three interconnected components that determine the success of economic development. Investment without an understanding of risk has the potential to cause losses, while financial literacy without investment implementation only results in passive knowledge. Therefore, the balance between the three is key to creating an inclusive, stable, and sustainable financial system. Further analysis shows that people who understand investment risk tend to have more stable investment behavior. They are not easily affected by short-term fluctuations and focus more on long-term financial goals. This behavior, in the long run, can increase capital market stability because it reduces volatility caused by speculative buying and selling. Cross-country research supports this finding. Gillani et al. (2023) found that in several Asian countries, a high level of financial literacy correlates positively with healthy risk tolerance, which in turn improves the quality of investment decision-making.

Investors who understand the capital market are better able to identify opportunities and diversify their portfolio to minimize potential losses. In addition, the literature highlights that the integration of financial literacy, risk understanding, and financial technology is an important foundation for the development of a sustainable investment ecosystem. The government and financial institutions have a strategic role in providing continuous financial education and encouraging innovation in easy-to-use investment technology. This effort is expected to create a society that is not only financially literate but also actively participates in economic development through healthy, rational, and long-term oriented investment (Silva et al., 2024). The literature findings confirm that investment success is not only determined by external economic factors but also by individual readiness and understanding. Investors who have adequate financial knowledge and are able to understand risk tend to make more measured and stable investment decisions.

Thus, increasing financial literacy, utilizing financial technology, and effective risk management are three main pillars in creating an inclusive and sustainable investment ecosystem. The synergy between these three aspects also contributes to a more equitable, stable national economic development that is capable of facing global uncertainty. The results of this study emphasize that the sustainability of economic growth and the equitable distribution of community welfare depend on the individual's ability to manage investment wisely, understand risk, and utilize financial literacy and financial technology. Therefore, the policies of the government, financial institutions, and national education must be aligned in encouraging the public to have the capacity to make smart, secure, and productive investment decisions, so that economic potential can be maximized sustainably, and community welfare increases equitably.

5. Discussion

The results of the literature analysis reveal a close connection between investment, financial literacy, and risk management in building economic stability while improving individual welfare. The relationship between these variables is synergistic, where increased financial literacy encourages more rational investment decision-making, while understanding risk helps maintain investment sustainability in the long run. This finding reinforces the statement by Raut (2020) that financial education is a crucial foundation in shaping public investment behavior, especially in the context of a complex and dynamic capital market. Financial literacy acts as a key factor in reducing speculative behavior and improving the quality of decisions based on analysis and information. This is in line with the findings of Fong et al. (2021) which show that financial literacy functions as a linking variable between the level of education and public participation in the capital market. Individuals who have a deep understanding of investment risks and opportunities tend to have a higher level of confidence in making investment decisions.

In addition, financial literacy helps the public avoid high-risk investment traps that are not suitable for their financial profile, thereby minimizing the risk of loss. On the other hand, investment risk is an important dimension that must be managed carefully and systematically. Furinto et al. (2023) emphasize that risk perception acts as a mediator between financial literacy and stock investment decisions. Investors who have a realistic and informed perception of risk tend to make more mature and long-term oriented decisions. Thus, risk management is not merely the responsibility of financial institutions but also an individual capability that needs to be built through continuous education and experience. From a macroeconomic perspective, Ma et al. (2023) affirm that investment is the main driver of economic growth. However, without an effective risk mitigation system, investment can lead to financial instability. Therefore, the government's role is very important in strengthening capital market regulations, providing protection for retail investors, and ensuring information transparency so that the investment ecosystem remains healthy and sustainable.

Besides regulation, cross-sector collaboration is also key to increasing financial literacy nationally. Integration between educational institutions, regulators, and the private sector allows financial knowledge to reach all levels of society (Odio et al., 2021). Thus, public participation in investment will increase, not merely due to market trend momentum, but based on mature financial awareness and adequate risk understanding. This discussion confirms that the success of the investment system depends on three main pillars: understanding, trust, and protection. Understanding is built through financial literacy; trust emerges from market transparency and clear information; while protection is guaranteed through appropriate policies and continuous education. The synergy between these three factors will create an investment ecosystem that is inclusive, stable, and capable of supporting sustainable economic development.

6. Conclusion

Based on the results of the literature analysis, it can be concluded that investment plays a strategic role in increasing economic growth and individual welfare. Investment not only functions as a means of capital formation and job creation but also as an instrument for individuals to achieve long-term financial goals and protect the value of wealth from inflation. However, the success of investment is highly dependent on the level of financial literacy and the ability to manage risk. Financial literacy is proven to have a positive relationship with rational investment decision-making and active participation in the capital market. A good understanding of risk and diversification allows investors to minimize potential losses and optimize investment results.

On the other hand, accurate risk perception is also an important factor in shaping healthy investment behavior. The government, educational institutions, and the financial sector need to collaborate in increasing public financial literacy through educational and inclusive programs. In addition, policies that encourage market transparency and investor protection will strengthen public trust in the national financial system. With increased financial understanding and risk management capabilities, the public can actively participate in productive and sustainable investment activities, thereby driving inclusive and stable national economic growth

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